

D0040001

Association Governance Partnership Recommendation

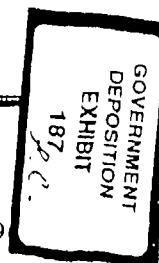
August 18, 1999

ATTORNEY/CLIENT PRIVILEGED

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CMB 01359



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Background

In recent years both MasterCard and VISA have sought to become the 'prime' or 'preferred' Association for their larger members

- marketing incentives have been a primary tool to leverage brand preference among members

Events of the last year have accelerated this effort

- larger members are seeking more influence in Association governance, brand activities, and budget process
- the Department of Justice suit focuses attention on acceptable alignment of issuers and Associations, as well as on proper activities of Associations
- consolidation of the industry has clarified that the primary competition that matters to Chase and to the consumer is among issuers seeking market share and advantaged cost position, rather than Associations competing for brand positioning

Background (cont.)

Chase, as a major industry player, has been approached by both MasterCard and VISA with partnership offers.

We have negotiated with each

- MasterCard is negotiating partnership deals one at a time
 - we understand Citibank, USAA, Fleet and Metris have agreed to long term (5 year) deals within parameters similar to what MasterCard has negotiated with Chase; we believe MBNA has negotiated a one year agreement with MasterCard
- VISA has published a five year partnership program open to all members who will commit to the terms
 - we understand BankOne and Bank of America as well as at least ten regional issuers, have agreed to the VISA partnership
- Separately, VISA has offered Chase a five year marketing incentive program of less value but requiring less commitment to the brand
 - VISA management has approved the general outline of this offer, but terms have not been finalized

Decision Criteria

Chase has developed these criteria for selecting the best partnership arrangement:

- Governance - Chase's ability to influence strategy and actions of the partner Association
- Economics - the value of lower costs, higher revenues, and incentives as a result of partnership terms
- Obligation and Protection of our Franchise - level of commitment to partner brand and ability to meet requirements with as minimal customer disruption as possible
- Brand Flexibility - Chase's ability to influence the Association's branding strategy, and the extent of flexibility afforded to Chase
- Compatibility of Vision - which Association's staff and Board are more likely to develop and successfully pursue a strategy that we believe best helps Chase and the Association win in the payments industry

Economics and Protection of Franchise

The offered deals have different structures. MasterCard is offering a negotiated deal within parameters of incentive and obligation. VISA has published a partnership program open to all members who will abide by the terms. Separately, VISA has offered Chase an incentive program premised on dedicating new acquisition to the brand.

	MasterCard	VISA Partnership	VISA Incentive
<u>Incentive</u>			
<u>Obligation</u>			

Governance - Chase's ability to influence strategy and actions of the Association.

Key Factors

- Number of board votes Chase controls vs. total number of board votes
- International and USA Board relationships
- Membership votes

A. Boards

MasterCard

- Our influence will be at the International Board level where we will have one of seventeen votes.

VISA

- VISA USA will have nine or ten issuing banks represented, and the presidents of VISA USA and VISA International
- Members who represent at least 10% of volume are entitled to two seats; one member (BancOne/FUSA) qualifies today and another (Bank America) may as well.
- Unless Chase can realize two seats, it will have one of twelve or thirteen votes.
- VISA International has considerable influence on VISA USA, and its board currently has 24 directors, of which seven are from US members.
- The International Board of VISA may impose significant costs on the US members to support needed changes in VISA Net.

Governance (cont.)

B. Membership Votes

- MasterCard gives full credit for merchant volume, and therefore Chase would hold the largest share membership votes (approximately 11%)
- VISA discounts the weight of merchant volume, putting Chase behind issuers who have larger cardholder volume

Brand Flexibility

Both Associations are promising issuers will be able to control the face of the card and, if they choose, place the acceptance mark on the back

- MasterCard currently allows this option
- VISA USA Board has approved this option; this needs to be ratified by the International Board
- the VISA International Board has approved a test with debit cards prior to ruling on the US Board request

Compatibility of Vision

- VISA USA has explored transforming VISA Net into a National Payment System, addressing all payment system components and reducing industry costs
- While there may be some option to share in future equity of a VISA payment system if Chase were a major VISA player, this option may conflict with other Chase options
 - there is also uncertainty if VISA USA can control VISA Net and insulate US members from expenses incurred on behalf of international members
- VISA's vision of its role in controlling branding of payment products is not compatible with Chase's intention to use our brand as a point of competition with other VISA members
- MasterCard envisions a payment infrastructure that would support Chase's position as a preferred payment provider for Chase customers
 - MasterCard takes a similar view supporting members' branding of payment products
- MasterCard offers a potential upside of equity participation
 - Chase would qualify for the largest equity share based on today's position as issuer and acquirer

Summary of Options

	MC Partnership	VISA Partnership	VISA Incentive	Status Quo (No Partnership)
Economics	<div>REDACTED</div>			
Obligation/ Franchise Impact				
Governance				
Brand Flexibility				
Vision				

Recommendation

Chase has prepared a contract draft to be presented to MasterCard. The draft provides for economic advantages of partnership and provides protections against the uncertainties of customer reaction to conversion and of governance decisions. If MasterCard agrees with this draft without material changes, Chase should enter a MasterCard partnership.

If MasterCard does not accept the draft, Chase should seek to negotiate a short term deal of marketing incentives, and review partnership options at a future date.

The key protections in the MasterCard draft are outlined on the following page.

Dealing with Uncertainty

Specific issues that affect the value and obligations of partnership are being negotiated contractually with MasterCard.

REDACTED

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Dealing with Uncertainty (cont.)

REDACTED

D0040013



Date: 8/20/99

HARRY DISIMONE, Executive Vice President
Chase Cardmember Services Admin. 5H2
(516) 934-3699

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TO: Don Boudreau
Mike Urkowitz

Please see the attached outline which describes the current
process with both Associations and provides a point of view
regarding Chase's position.

Please let me know if you concur.

Harry

CC: Mark Segall
Matt Leonard

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* * * TRANSMISSION RESULT REPORT (AUG. 20. 1999 7:43AM) * * *

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